VZCZCXRO1747
RR RUEHRG
DE RUEHSO #0531/01 2521726
ZNR UUUUU ZZH
R 091726Z SEP 09
FM AMCONSUL SAO PAULO
TO RUEHC/SECSTATE WASHDC 9554
INFO RUEHBR/AMEMBASSY BRASILIA 0689
RUEHRG/AMCONSUL RECIFE 4422
RUEHRI/AMCONSUL RIO DE JANEIRO 9245
RUEHBU/AMEMBASSY BUENOS AIRES 3617
RUEHAC/AMEMBASSY ASUNCION 0002
RUEHMN/AMEMBASSY MONTEVIDEO 2961
RUEHSG/AMEMBASSY SANTIAGO 0002
RUEHLP/AMEMBASSY LA PAZ 4141
RUCPDOC/USDOC WASHDC 3285
RUEATRS/DEPT OF TREASURY WASHDC
RHEHNSC/NATIONAL SECURITY COUNCIL WASHDC

UNCLAS SECTION 01 OF 02 SAO PAULO 000531

SIPDIS
SENSITIVE

E.O. 12958: N/A
TAGS: ECON EFIN ETRD EINV BR
SUBJECT: BRAZILIAN BUSINESS SEES RECOVERY UNDERWAY

REF: (A) SAO PAULO 320; (B) BRASILIA 950

SENSITIVE BUT UNCLASSIFIED--PLEASE PROTECT ACCORDINGLY

¶1. SUMMARY: Following two quarters of economic contraction, most Brazilian private sector representatives agree the local economy is solidly on the road to recovery. Restored domestic consumer confidence and strong domestic demand are fueling business optimism. Underlying factors contributing to quick turnaround include increased financial sector lending, rising retail sales driven by government tax measures, relaxed monetary policy, and recovering commodity prices. Brazil has seen relatively less progress in recuperating pre-crisis levels of investment spending and industrial production. Overall 2009 annual GDP growth may still fall slightly negative, but Brazilian business is planning for robust growth around four percent in 2010. Sustaining this level of growth amid a weaker global recovery, however, will remain a challenge. END SUMMARY.

Banking Sector Leading the Way

¶2. (U) The banking sector has spearheaded Brazil's recovery, among the 14 major sectors, generating USD eight billion in revenues during the first half of this year. State-owned Banco do Brasil has regained its position as Latin America's largest bank and boosted profits by 43 percent, as a result of a government-mandated measure to lower interest rates and lessen lending restrictions. Banco do Brasil's total lending expanded 33 percent, compared to 15 and 18 percent by Itau Unibanco and Santander, the second and third largest Brazilian banks, respectively. Banco do Brasil's average interest rate for consumer credit was 34 percent in July, compared with 61 at Itau and 80 at Bradesco, according to Brazil's Central Bank. (Comment: Brazilian banks enjoy some of the highest interest rate spreads in the world, as the above numbers demonstrate.) In August, Finance Minister Guido Mantega publicly credited government-controlled banks' increased lending for helping the nation out of its first recession since 2003, while domestic media has criticized private banks such as Itau Unibanco and Santander for not implementing similar measures.

¶3. (SBU) Rubens Sardenberg, chief economist at the Federation of Brazilian Banks (FEBRABAN), told Econoff that private banks are not concerned about the criticism generated by the media, as business remains strong for these banks. He attributed the greater lending prudence followed by private banks as a measure to secure stable long-term payments. However, Marcelo Carvalho, Chief Economist at

Morgan Stanley, suggested to us that private banks lost a significant opportunity to expand their customer base by not lowering rates along with Banco do Brasil earlier in 2009. With the Brazilian economy now solidly in recovery, he expects both public and private banks to further boost efforts to facilitate access to credit.

--- --
Rising Confidence & Commodity Prices Boost Real
--- --

¶4. (SBU) Meanwhile, as a result of GoB expansionary measures such as automotive, household appliances, and electronics tax breaks, private sector consumption has proven resilient. For example, June retail sales grew by 5.6 percent from a year ago, with computer equipment sales increasing as much as 15.6 percent. The boost in retail sales indicates a recovery in consumer confidence while business confidence indicators have also recovered by 25 percent since February, according to Morgan Stanley research, with data from the Gertulio Vargas Foundation. Together, the rising confidence levels are spurring optimism among our Morgan Stanley and Santander contacts that the economy is poised for a strong GDP growth in 2010 around four percent.

¶5. (SBU) A rebound in average commodity prices, climbing 31 percent in dollar terms since the end of February, is another key factor contributing to Brazil's economic rebound. Commodities represent about half of Brazil's total exports, according to Morgan Stanley's analysis. (Note: Morgan Stanley's definition of commodities includes meat products such as chicken, beef, pork, as well as semi-manufactured goods such as soybean products. End Note.)

Commodity gains are also boosting share prices. Brazil's Bovespa index has jumped 52 percent so far this year on speculation that a rebound in commodity prices and record-low interest rates will bolster economic growth. Greater-than-expected international demand for Brazilian products, particularly from China, is also contributing to analysts' optimism for a robust recovery.

¶6. (SBU) Higher retail sales, export levels and commodity prices are fueling the appreciation of Brazil's real, which has strengthened 27 percent against the dollar this year and is expected to close 2009 at 1.8 real per USD. Since January 1, Brazil's real is the best-performing currency among all 171 currencies tracked by Bloomberg. Standard Chartered, a London based bank, predicts Brazil's real will climb 18 percent by the end of 2010, reaching an 11-year high of 1.55 reais per USD.

Countercyclical Monetary Policy

¶7. (SBU) While many in the business community believe that interest rates are still too high, most acknowledge that the Central Bank's aggressive cuts of 500 basis points to the benchmark SELIC rate since last year have spurred economic growth. However, with the expansionary monetary cycle seemingly winding down following the Bank's September 3 decision to keep the SELIC rate at 8.75 percent, criticism from the influential Sao Paulo Federation of Industries (FIESP) for more interest-rate cuts has grown. FIESP and others argue that, unlike the 2003 crisis, inflation remains near the Bank's target rate of four percent which provides room for further monetary loosening.

Comment

¶8. (SBU) Brazil, unlike in previous economic crises, appears to be recovering faster than other more developed nations. Current market consensus is that Brazil's economy almost certainly will grow at around four percent next year. As our business interlocutors note, its success is due to internal economic stimulus policies, strong domestic demand and external variables such as recovering commodity prices. Nevertheless, they agree that expanding access to credit remains key to future economic growth, and a full recovery to

pre-crisis levels of investment and industrial production remain key goals for 2010.